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# FREE TRADE IN THE AMERICAS

# REGIONAL TRADE AGREEMENTS AS NATIONAL SECURITY POLICY


by

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## Disclaimer

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## *Abstract*

Increasingly, America's security objectives are defined by U.S. economic interests. In Latin America, closed economies and authoritarian governments are transitioning to market-oriented systems and democratic institutions, resulting in increased goodwill and cooperation between the U.S. and Latin America. In 1993, President Clinton pushed hard and won congressional approval on the North American Free Trade Agreement (NAFTA) between the U.S., Canada, and Mexico. Along with this, he orchestrated the landmark Summit of the Americas in December 1994 between the U.S., Canada, and the democratically-elected leaders of Latin America and the Caribbean. The result of the "Miami Summit" was a proclamation that the nations of the Western Hemisphere would establish a hemispheric free trade area with a target date of 2005. However, in 1994 and 1995, the peso crisis, brought on by a series of problems within Mexico, caused that country's financial system to collapse along with the hopes for a hemispheric free trade pact in the near future. This paper argues that, while NAFTA and its South American counterpart (Mercado Comun del Sur, or MERCOSUR) are formed on an economic basis, the true value of a regional free trade agreement is as a national security strategy tool. It also looks at NAFTA and MERCOSUR in detail, examines the power relationship between countries in the region, and discusses those issues of greatest concern to the U.S. regarding a free trade expansion within Latin America. Ultimately, the U.S. should pursue and expand its current strategy because of foreign policy implications and it should not

allow its long-term interests to be derailed because of temporary setbacks in the financial and trade arena.

## Chapter 1

# Introduction

The Cold War is over. Increasingly, America's security objectives are defined by U.S. economic interests. In Latin America, a new era is dawning, with formerly closed economies and authoritarian governments transitioning to market-oriented systems and democratic institutions. The combination of these trends has generated an increased feeling of goodwill and cooperation between the U.S. and Latin America. Capitalizing on this, President Clinton pushed hard and won congressional approval on the North American Free Trade Agreement (NAFTA), a wide-ranging series of economic measures designed to increase trade between the U.S., Canada, and Mexico. He also orchestrated the landmark Summit of the Americas in December 1994 between the U.S., Canada, and the democratically-elected leaders of Latin America and the Caribbean. The result of the "Miami Summit" was a proclamation that the nations of the Western Hemisphere would establish a hemispheric free trade area with a target date of 2005. In 1994 and 1995, the peso crisis, brought on by a number of systemic problems within Mexico, caused that country's financial system to collapse along with the hopes for a hemispheric free trade pact anytime in the near future. This paper argues that, while NAFTA and its South American counterpart (Mercado Comun del Sur or MERCOSUR) are formed on an economic basis, the true value of a regional free trade agreement is as a national security strategy tool. Essentially, the U.S. should pursue and expand this strategy because of its foreign policy implications and not allow our long-term interests to be derailed because of temporary setbacks in the financial and trade arena.

# Chapter 2

## History of Trade Agreements in the Americas

The first modern attempt at establishing trade agreements between Latin American countries was the Latin America Free Trade Area (LAFTA), established in June 1961 as a product of the Treaty of Montevideo (signed in 1960). The original signatories were Argentina, Brazil, Chile, Ecuador, Mexico, Paraguay, Peru, and Uruguay—Bolivia and Venezuela joined the association in 1966 and 1967, respectively. The goal of LAFTA was to create an almost completely liberalized regional market over a 12-year period, ultimately resulting in minimal or no tariffs between member countries. From the very beginning, commercial integration proved to be too difficult, largely resulting from a lack of commitment and progress by member nations towards agreed upon tariff reduction guidelines. Much of the problem was also due to economic instability in two critical LAFTA nations—Argentina and Brazil. This uncertainty seriously reduced their willingness to aggressively move toward intra-regional trade reform. Eventually, LAFTA was replaced in 1980 by the Latin American Integration Association (LAIA), an organization with much more modest goals and which is still functioning today.[1]

In Central America, the General Treaty of Economic Integration was signed by Guatemala, El Salvador, Honduras, and Nicaragua in December 1960, establishing the Central American Common Market (CACM). Immediately after signing, tariff free intra-regional trade was adopted and a common external tariff was established. While this strategy continues to be successful within CACM, it is largely attributed to the economic homogeneity of the members and the lack of political strength of domestic import competing sectors. CACM, for these reasons, is not seen as a model to base other regional trade agreements upon.[2]

In 1969, Bolivia, Colombia, Chile, Ecuador, and Peru signed the Cartagena Agreement establishing the Andean Group (AG), created specifically to rectify the inconsistencies which resulted in the poor performance of LAFTA. AG's main objectives were to liberalize intra-regional trade, achieve a common external tariff, balance the costs and benefits of the integration process, and establish a code for common treatment of foreign direct investment. The goals, however worthy, have fallen far short of original expectations due to several factors. Primarily, AG has been unsuccessful because of the excessive number of intra-regional tariff "exemptions," difficulties in designing a common external tariff, and failure to establish a coordinated, agreed-upon regional industrial planning strategy. While modest improvement has occurred, AG exports traded among members has only grown from 1.7 percent in 1970 to around 4 percent now.[3]

LAFTA personified the defining feature of Latin American economic development during the 1950s, 1960s, and 1970s. Unlike modern trade agreements, which seek to expand markets to other regions by lowering tariff barriers, LAFTA sought to establish autonomy in manufacturing activity in individual Latin American economies by restricting imports. Essentially, LAFTA was designed to protect local industry by making imports too costly. This strategy failed because the policy of import substitution generally resulted in high-cost, low-quality production. Forced to reconsider their policies by the debt crisis of the 1980s, Latin American governments understood the need to change and began to deregulate their economies and liberalize trading relationships.[4]

**Notes**

[1]Sebastian Edwards, “Latin American Economic Integration: A New Perspective on an Old Dream,” *The World Economy*, May 1993, pp. 319–20.

[2]Edwards, p. 321.

[3]Edwards, pp. 322–24.

[4]Michael Gestrin and Alan M. Rugman, “Economic Regionalism in Latin America,” *International Journal*, Summer 1994, p. 570.

# Chapter 3

# Trade Agreement Models

Realizing the old, import-restricting policies had to change, many Latin American governments embarked upon a significant restructuring of their economic policies.  Key to the new strategy was the establishment of viable, long-term regional trade agreements with the intent to stimulate economic growth through an expansion of the export sector, while increasing import availability at the same time.  This chapter will explore the framework of the two major free trade agreements in North and South America, examining the guiding principles and concepts behind each, along with a description of the main economic arguments supporting these arrangements.

## North American Free Trade Agreement

### NAFTA Provisions and Goals

NAFTA is, in many respects, a new and improved version of the Canada-U.S. Free Trade Agreement (CUSTA) of 1988.  Ratified in 1993, NAFTA includes the United States, Canada, and Mexico in a far-reaching agreement encompassing the following provisions and goals:

1. Eliminate almost all tariff and non-tariff regional trade barriers within 10 years;
2. Establish free trade in agricultural products between US and Mexico within 15 years;

3. Extend CUSTA's innovative dispute settlement procedures to include Mexico;
4. Enact precedent-setting rights and obligations regarding services and investment; and
5. Take an important first step in addressing cross-border environmental issues.[1]

### U.S. Reasons for NAFTA Approval

The arguments for U.S. approval of NAFTA largely focused on the economic impacts of the agreement. In 1993, William A. Orme, Jr., a journalist specializing in Latin American issues, effectively summed up these arguments as:

1. NAFTA adds a 300 billion dollar economy to the US-led trading "bloc;"
2. On a generally rational basis, NAFTA favors competitive, high-wage industries over businesses dependent on subsidies or cheap labor;
3. NAFTA opens critical service sectors in Mexico, including banking, communications, transportation, insurance, publishing, beachfront tourism, film distribution, retailing, educational training, civil engineering, software design, natural gas and electric power distribution, and construction (public works projects estimates exceed $100 billion over the next five years);
4. NAFTA potentially increases a $40 billion annual export market for the US;
5. Under NAFTA, Mexico would be a better place to do business, with lower financial costs, an improved infrastructure, and a larger pool of trained bilingual personnel;
6. NAFTA lowers critical industry barriers, such as Mexican auto import restrictions; giving American companies an immediate opportunity to fully employ underused plants;
7. NAFTA exerts legal and economic pressure to shutdown minimum wage border plants;
8. Economic integration has given Mexican environmentalists real political leverage;
9. NAFTA creates Mexican employment opportunities, helping the immigration problem;
10. NAFTA guarantees Mexico gets the capital and market access it needs to survive; and
11. If the US ever decides NAFTA is not in its best interests, it can leave in six months.[2]

In addition to most of Orme's arguments, noted experts Gary Clyde Hufbauer and Jeffrey J. Schott add some of their own. Again, their main reasons in favor of ratification primarily center around economic issues. Hufbauer and Schott estimated in late 1993 that employment in the US would grow, modestly, by about 320,000 jobs due to NAFTA, while there would be around 150,000 US workers displaced because of NAFTA-related job shifts (a net gain of 170,000). Additionally, with 75 percent of all Mexican merchandise imports coming from the United States, Mexico is currently one of the world's best markets for American goods and services—a market with tremendous growth potential which would be more closely integrated with the U.S. because of NAFTA. Also, NAFTA provides an "insurance policy" of sorts for U.S. investors, reducing the hazards of doing business in Mexico by establishing agreed-upon rights and obligations in a variety of areas. Consequently, this "safety net" encourages more U.S. firms to open facilities in Mexico. Hufbauer and Schott estimated that Mexican capital stock would grow by $60 billion over several years as a result of NAFTA, with most of that investment belonging to Americans. Along with these advantages, NAFTA "levels the playing field" in a market already favoring Mexican exporters. With Mexico receiving virtually unfettered access to the American market (U.S. tariffs on Mexican products averaged less than 4 percent), NAFTA lowered the 11-20 percent average Mexican tariffs by a proportionally much greater amount, giving American firms a comparative advantage compared to pre-NAFTA arrangements. Finally, NAFTA establishes critical rights and obligations regarding investments, intellectual property, the environment, and labor issues, along with including Mexico in a formalized dispute-resolution procedure.[3]

**Canada's Reasons for NAFTA Approval**

As the second largest economic power in the western hemisphere, it is critical and instructive to consider the Canadian perspective on NAFTA. Canada's main objective in initiating a free trade agreement with the U.S. was "to instill a trade and investment climate which could contribute . . . to the creation of more and better employment opportunities." Additional objectives, as listed by the Canadian government were: (1) the attainment of security of access through reducing the risks of United States contingency protectionism; (2) the improvement of access to ensure a sufficiently large market to realize economies of scale as well as access to world technology; and (3) the ordered adjustment towards a more competitive Canadian economy, particularly providing increased incentives for investment from all sources.[4] Essentially, Canada felt CUSTA was primarily a means to secure market access and deal with "the problem of American protectionism." Along with this, a free trade agreement was reached with the U.S. to insure international competitiveness through achieving greater economies of scale, and to initiate reform in the philosophy and operation of Canadian government and its policies of economic intervention.[5] While CUSTA was a source of much debate in Canada, NAFTA caused very little discussion. In short, Canada's decision to enter NAFTA negotiations was easy—"its concern was not Mexico or, even less, Canadian-Mexican trade, which was insignificant; rather, the focus was on the impact of the Mexico-United States relationship on Canada's own relationship with the United States."[6] Canada was concerned it might lose its preferential advantage with the United States if it did not join a U.S.-Mexico agreement. Additionally, while U.S. firms could trade tariff-free with Mexico and Canada, Canadian firms could only trade tariff-free with the U.S. (not Mexico) without Canada's participation in NAFTA, thereby reducing their competitiveness. Not joining NAFTA would put at risk some of the advantages Canada thought it had gained in negotiating CUSTA in the first place. Finally, Canada joined NAFTA negotiations to fix things that CUSTA had left unresolved, such as dispute resolutions and some customs issues.[7]

**Mexico's Reasons for NAFTA Approval**

Of all the participants, Mexico stood to gain the most from joining NAFTA. In early 1994, Guy Poitras and Raymond Robinson, two American experts in Latin America, summed up the primary economic reasons for Mexican participation in NAFTA as follows:

1. It would allow the government to strengthen and consolidate an economic restructuring that was already underway;
2. It would help lower domestic inflation through increased competition from imports;
3. It would help Mexican firms use their capital and export capacity to reap the largest possible gains from a more open economy;
4. It would help deflect U.S. protectionism as well as the potential threat posed by the Super-301 provisions of the Omnibus Trade and Competitiveness Act enacted in 1988 (these provisions deal with U.S. response to unfair trade practices);
5. NAFTA should prove an attraction for private foreign investors and help to restore their confidence in the Mexican government;
6. It would legitimize and manage on an official basis Mexico's "silent integration" with the U.S. economy, which was already well-advanced;
7. It would provide Mexico with an economic refuge from the European and Asian trading blocs;
8. It would heighten Mexican competitiveness in manufactured exports; and
9. Most importantly, it would re-ignite economic growth and help create jobs.[8]

It is important to note that while most of the key decision-makers and influentials in Mexican society (the president, the governing Partido Revolutionario Institutional (PRI), powerful business interests, large labor unions, and the intellectual community) were firmly behind NAFTA, this is not the equivalent of overall Mexican acceptance of NAFTA and what it represents. Under Mexico's hierarchical society and authoritarian system of government, there was no significant debate within society at large regarding this major redirection of national economic policy.[9] This lack of popular expression is markedly different from the national debate that occurred in the U.S. and Canada. Despite the divisiveness NAFTA passage may have caused because of the heated debate in the United

States, the citizens of the U.S. and Canada are generally more informed and willing than Mexican citizens to support NAFTA as a result. While opinion polls were generally in favor of NAFTA's acceptance in Mexico, this lack of popular understanding and "soft" support caused major problems in Mexico and will be explored later.[10]

## Mercado Comun del Sur

### The MERCOSUR Agreement

In March 1991, Argentina, Brazil, Paraguay and Uruguay signed the Treaty of Asuncion, establishing the "Southern Cone's Common Market," or MERCOSUR. Like NAFTA, MERCOSUR is based upon a bilateral agreement between the two largest countries in the region; in this case, it was a trade pact between Argentina and Brazil signed in 1988.[11] Much like Mexico's decision to enter trade negotiations with the United States and Canada, the decision to form MERCOSUR was essentially an executive decision by the most powerful private and governmental interests in all four countries. Only in Uruguay was there congressional and public debate regarding treaty ratification.[12] Jaime Behar of the Institute of Latin America Studies of Stockholm University summed up MERCOSUR as a free trade agreement designed to (1) establish tariff-free trade between the four countries within five years (Uruguay and Paraguay were given six years to complete the process); (2) create a process of tariff alignment, converging toward a relatively low Common External Tariff (CET) for goods coming from non-member countries; (3) establish a common four-country customs union for import of externally-produced goods; and (4) eliminate non-tariff barriers to intra-MERCOSUR trade, such as quotas, differential exchange rates, customs valuation based on fixed prices, and other administrative “protection” controls.[13] Luigi Manzetti of Southern Methodist University also includes that MERCOSUR signatories agreed to develop accords for specific sectors of the economy to optimize their use and achieve economies of scale, implement an institutional framework to solve trade litigation, create a Council of the Common Market for establishing general policy guidelines, and establish the Common Market Group as the executive institution of MERCOSUR.[14] Despite the attempt to make this free trade agreement similar to a common market-type arrangement like the European Community (EC), MERCOSUR has been criticized because it does not deal with critical sectors such as agriculture and labor.[15] From an economic perspective, MERCOSUR is fundamentally interested in increasing trade between member nations, and between non-members and the union as a whole. While many issues have been discussed at subsequent summits, MERCOSUR remains an association which is not as extensive in its content as NAFTA or the EC (an even larger, more inclusive organization).

**Reasons for Forming MERCOSUR**

Manzetti described the principal economic reasons why the Southern Cone nations established MERCOSUR:

1. Deregulation and trade liberalization mean the market, rather than the state, is the ultimate referee on how resources are allocated;
2. MERCOSUR provides larger markets, greater volume of trade, and better opportunities to develop specialization;
3. Liberalizing first with neighbors provides many benefits while still ensuring regionalized protection against more efficient global producers;
4. MERCOSUR provides the means to diversify and expand exports at a time when the world economy appears to be more prone to protectionist measures; and
5. Regional integration serves as a powerful magnet to attract new external investment and technology, providing the opportunity for capital to expand into larger markets via common external tariffs, rules of origin, and regulations.[16]

Finally, much like a Canadian reason for joining NAFTA, Uruguay (dwarfed by Brazil's and Argentina's economies) perceived itself as being forced to join a regional integration scheme to avoid being shut out of accords between its neighbors.[17] In both NAFTA and MERCOSUR, relatively smaller neighboring nations have felt compelled to join an agreement so they would not be "left out" of regional economic progress. While large nations frequently influence smaller ones in many areas, it is interesting to note this correlation between these two free trade agreements.

## NAFTA and MERCOSUR: A Comparison

Sidney Weintraub, the Director of the US-Mexico Policies Center at the University of Texas at Austin, referring to NAFTA and MERCOSUR as "magnets," has identified them as the only two regional free trade agreements which could reasonably be expanded into a hemispheric free trade association.[18] Under current provisions, joining NAFTA would entail each new nation to accept the far-reaching obligations required of the three current members. Weintraub sums up the dilemma many Latin America and the Caribbean countries (LAC) now face in this regard:

> Few LAC countries are now prepared to commit themselves to the full array of obligations in NAFTA. The principal obligations deal with phased elimination of border barriers, but there are many more. These include national treatment for investment, free trade in services, establishment of rules of origin consistent with NAFTA, opening public procurement to other NAFTA countries, alteration of laws to facilitate settlement of disputes, acceptance of discipline in promulgating new national regulations that might compromise the benefits of other member countries, acceptance of compatible product and safety standards, adherence to the supplemental agreements on environment and labor, and greater protection of intellectual property. *Many of these ostensibly economic reforms have substantial political implications, and some are highly controversial in LAC countries* (italics added).[19]

One possible solution to this problem is to give prospective members associate status until they are ready to join.[20] This would be analogous to the free trade arrangements made with Austria, Finland, Norway and Sweden by the EC prior to their acceptance as full members. Under any circumstances, it is apparent that expanded membership in NAFTA would be problematic for a great many Western Hemisphere nations.

MERCOSUR is the other viable alternative to NAFTA. Much less inclusive in its scope, admittance into MERCOSUR would primarily involve adaptation to the grouping's Common External Tariff. Theoretically, membership in one organization does not preclude membership in the other, nor does it prevent bilateral agreements with third-party nations. Accession to MERCOSUR, however, prevents that member nation from joining other regional trade pacts. Chile, with lower tariffs than those mandated by MERCOSUR, has approached this issue by suggesting it be granted "associate" membership.[21] Finally, while MERCOSUR represents about one-tenth the economic might NAFTA does, it plays a significantly greater role for those nations in immediate proximity to Brazil (and, to some degree, Argentina) and, consequently, might very well provide a more attractive regional trading bloc for many of the South American nations.

**Multilateral Trade Agreements**

Superimposed against these regional trade agreements is The Uruguay Round, the multilateral trade agreement which took effect in 1995 and greatly expanded the areas covered by the 1947 General Agreement on Tariffs and Trade (GATT). The Uruguay Round strengthened international trade rules and provided the basis for the creation of the World Trade Organization, which monitors trade relations of the more than 120 member nations. The agreement breaks new ground in covering areas such as services, intellectual property rights, and investment measures.[22] The U.S., along with most Latin American countries, are full signatories to The Uruguay Round. It is "now more critical than at any other time in this century" for America's future to expand trade.[23] In the last two years, U.S. exports have increased by $100 billion and might reach $1.2 trillion by 2000.[24] Joseph A. McKinney, an economist from Baylor University, has identified regionalism as a major perceived threat to the world trading system.[25] The specter of three major regional trade blocs, embodied by an expanded NAFTA, the EC, and the East Asian Economic Caucus (a subgroup of the Asia-Pacific Economic Cooperative, or APEC), set off alarms when the issue was first raised in the early 1990s.[26] Far from being a competitive or contradictory situation, however, regional free trade areas (such as NAFTA and MERCOSUR) can be the building blocks for a "stronger and broader" GATT, if they conform to its basic principles.[27] Peter Cowhey and Jonathan Aronson from the University of California at San Diego and the University of Southern California, respectively, assert that regional agreements may actually be superior ways to solve international trade problems, because of the ability to negotiate distinct side deals allowing for specialized enforcement and monitoring institutions.[28]

**Western Hemisphere Free Trade Area (WHFTA)**

At the Summit of the Americas in December 1994, the concept of a hemispheric trade area was the primary focus of the leaders of all democratically-elected governments of the Western Hemisphere. As presented, a WHFTA is likely to include all or most of the following provisions: (1) a regional free trade regime that eventually includes every nation of the Americas; (2) The elimination of restraints to the free flow of goods and capital; (3) the development of effective mechanisms for resolving disputes; and 4) a practical strategy for managing relations with those countries unable or unwilling to meet the requirements of a free trade pact.[29] Considered "vital to U.S. security," the year 2005 was agreed upon as target date for WHFTA implementation.[30]

**Notes**

[1]Gary Clyde Hufbauer and Jeffrey J. Schott, *NAFTA: An Assessment,* Washington: Institute for International Economics, February 1993, pp. 2–3.

[2]William A. Orme, Jr., "NAFTA: Myths versus Facts," *Foreign Affairs,* November/ December 1993, pp. 3–12.

[3]Gary Clyde Hufbauer and Jeffrey J. Schott, "Prescription for Growth," *Foreign Policy*, Winter 1993–94, pp. 104–112.

[4]Gilbert R. Winham, "NAFTA and the Trade Policy Revolution of the 1980s: A Canadian Perspective," *International Journal,* Summer 1994, p. 479.

[5]Winham, p. 480.

[6]Winham, p. 492.

[7]Winham, p. 496.

[8]Guy Poitras and Raymond Robinson, "The Politics of NAFTA in Mexico," *Journal of Interamerican Studies and World Affairs*, Spring 1994, p. 7.

[9]Poitras and Robinson, p. 8.

[10]Poitras and Robinson, p. 8–27.

[11]Jaime Behar, "Measuring the Effects of Economic Integration for the Southern Cone Countries: Industry Simulations of Trade Liberalizations," *The Developing Economies*, March 1995, pp. 4–5.

[12]Hector Alimonda, "Mercosur, Democracy, and Labor," *Latin American Perspectives*, Fall 1994, p. 23.

[13]Behar, p. 6.

[14]Luigi Manzetti, "The Political Economy of MERCOSUR," *Journal of Interamerican Studies and World Affairs,* Winter 1993–94, pp. 105–6.

[15]Alimonda, pp. 26–27.

[16]Manzetti, pp. 112–14.

[17]Alimonda, p. 24.

[18]Sydney Weintraub, "The Importance of Trade in the Western Hemisphere," *Journal of Interamerican Studies and World Affairs*, Fall 1994, p. 162.

[19]Weintraub, p. 163.

[20]Weintraub, p. 165.

[21]Weintraub, p. 163.

[22]Richard Harmsen, "The Uruguay Round: A Boon for the World Economy," *Finance & Development*, March 1995, p. 24.

[23]Jeffrey Garten, "Is America Abandoning Multilateral Trade?," *Foreign Affairs,* November/December 1995, p. 51.

[24]Garten, "Is America . . .," p. 52.

## Notes

[25]Joseph A. McKinney, "The World Trade Regime: Past Successes and Future Challenges," *International Journal*, Summer 1994, p. 463.

[26]McKinney, pp. 463–66, and John H. Jackson, "Regional Trading Blocs and the GATT," *The World Economy*, March 1993, pp. 121–24.

[27]Garten, "Is America . . .," p. 59.

[28]Peter F. Cowhey and Jonathan D. Aronson, "A New Trade Order," *Foreign Affairs*, 1993, p. 192.

[29]The Inter–American Dialogue, *The Americas in 1994: A Time for Leadership*, Washington, October 1994, p. 6.

[30]William J. Perry, *United States Security Strategy for the Americas*, Washington, September 1995, p. 8.

## Chapter 4

# Trade as Foreign Policy and a Regional Security Tool

### Free Trade as National Security Policy

Foreign trade has played a critical role in defining security requirements throughout the 220-year history of the U.S. With the demise of the Soviet Union as a military and ideological threat and the rise of economic powers like Japan and China, economic and national security are more than ever described as one in the same. President Clinton, in his 1995 national security report, defined the three central components of his strategy of engagement and enlargement as:

> Our efforts to enhance our security by maintaining a strong defense capability and promoting cooperative security measures; *our work to open foreign markets and spur global economic growth*; and our promotion of democracy abroad (italics added).[1]

The importance of U.S. leadership as a champion of international free trade was high-lighted when President Clinton stated "the vote for NAFTA marked a decisive U.S. affirmation of its international engagement."[2] Once again emphasizing the importance of U.S. economic policy as a critical component of national security policy, he goes on to say:

> This decision (to assist Mexico during its peso crisis) reflected the President's belief that the United States has a strong interest in prosperity

> and stability in Mexico and that *it is in our economic and strategic interest that Mexico's economic program succeeds* (italics added).[3]

Indeed, President Clinton states "our economic and security interests are increasingly inseparable. Our prosperity at home depends on engaging actively abroad."[4] Looking ahead, he emphasized the need to accelerate progress toward free, integrated markets throughout the Americas by creating a hemispheric free trade zone, with NAFTA as its first step.[5] Further emphasizing the importance of President Clinton's vision, the Institute for National Strategic Studies stated "the implementation of NAFTA—and the prospect of broadening it to include other states in the region—is the single most important incentive to economic reform in the Americas, and is a cornerstone of economic security at home."[6]

Independent of U.S. government analysis, scholars have reaffirmed the increased importance of free trade as a foundation of national security policy. Jeffrey Garten, a finance and economics professor at Columbia University, stated that "a vigorous trade policy, which gains greater access for American firms to foreign markets and keeps our markets open to others, will help ensure a competitive economy at home. A more effective international economic policy, based heavily on trade competitiveness, *will enhance U.S. influence around the world at a time when our military assets will be deployed with decreasing frequency*" (italics added).[7] Despite the recent military deployments to Rwanda, Haiti, and Bosnia, the number of U.S. servicemen stationed overseas is a fraction of what it was just six or seven years ago during the Cold War. The overall U.S. trend in pulling back our overseas presence is particularly apparent in Latin America, where United States Southern Command will move its headquarters from Panama to Miami at the end of this century, just three years from now.

Paul Krugman, an economics professor at the Massachusetts Institute of Technology, goes even further in describing free trade agreements as national security policy when he asserts that:

> The truth about NAFTA may be summarized in five propositions:
>
> 1. NAFTA will have no effect on the number of jobs in the United States;
> 2. NAFTA will not hurt and may help the environment;
> 3. NAFTA will, however, produce only a small gain in overall U.S. real income;
> 4. NAFTA will also probably lead to a slight fall in the real wages of unskilled U.S. workers;
> 5. *For the United States, NAFTA is essentially a foreign-policy rather than an economic issue* (italics added).[8]

The critical U.S. foreign policy issue Krugman feels is at the heart of NAFTA is that "Mexico's government needs NAFTA and the United States has a strong interest in helping that government."[9] The United States needs a secure Mexico, and NAFTA is a major step towards stabilizing Mexico's fragile economic and political reforms. By extension, this policy towards Mexico, with whom we have much greater economic interests than any other Latin American country, can be applied to many other nations who are also undergoing remarkable political and economic transition. Even John Saxe-Fernandez, a social and political science professor at the Ciudad Universitario, Mexico, and an outspoken critic of NAFTA, describes NAFTA as primarily "an instrument of (U.S.) political and security interests," albeit with less than flattering intent.[10]

## National Power Defined in Economic Terms

To understand the dynamics of trade as foreign policy and a regional security tool, it is necessary to examine the power relationships among the nations of North and South America. As seen in the cases of both Canada and Uruguay, a major reason for their joining NAFTA and MERCOSUR, respectively, was the perception that it would be far more detrimental to be excluded from agreements involving much larger neighbors (the U.S. and Brazil). This sense of relative power is a critical measure of how much a nation might be able to influence interstate activities within the world, its hemisphere, or its neighborhood. Because power is a relative relationship, it is essential to look at the comparative position of key nations in both North and South America based on some standard measures or indicators.

## The Hierarchy of Power in the Americas

To help understand the issues associated with creating and implementing a hemispheric free trade agreement, this section will examine the "hierarchy of power" in the Western Hemisphere. In 1993, three Canadian scholars (Gordon Mace, Louis Belanger, and Jean Philippe Therien) did a study of the relative power of each nation in North and South America and the Caribbean.[11] In their analysis, they acknowledge that a comprehensive comparison of relative power would focus on the "four dimensions of a state's capabilities:" (1) geography (population, territory, natural resources); (2) the economy (economic power, commercial power, level of development); (3) the political dimension (stability of regimes, cohesion, diplomatic involvement, etc.); and (4) the military dimension (budgetary expenses, size of conventional and nuclear forces). The authors decided to measure each American state's capabilities against each other in six different areas—population, gross domestic product (GDP), GDP per capita, defense spending, diplomatic missions, and total exports. A final measurement was made giving an aggregate total of the six areas for an overall relative power comparison. The authors also gave an indication of relative increase or decrease by measuring three different periods (1966-69, 1976-79, and 1986-89) for each country in each area and the aggregate.

**U.S. Power Compared to North and South American Nations**

A comparison of these measures yields an inescapable conclusion regarding the U.S. position: The United States holds a commanding lead over all other nations in the hemisphere in all six areas listed above and is clearly the dominant nation in North and South America, with no other country even close to its position as leader. With the United States enjoying this overwhelming position of relative power in the Americas, it is clear that any large regional trade agreements (such as the WHFTA) will only be successful if the U.S. plays the leading role in its development and operation.

**Comparative Relationships among Latin American Nations**

It is important to also understand the power relationship between Latin American countries (and especially between Brazil and its neighbors), for this will determine regional leadership, developmental issues and the terms which trade agreements will revolve around. Looking beyond the overwhelming lead the U.S. enjoys, it is apparent there is a distinct pattern of power relationships among the Latin American nations. Brazil is the clear leader among South American countries, being two to four times as big as its closest neighbors (Argentina and Venezuela) in all economic categories, except GDP per capita. Additionally, the relationship between Brazil and its smaller neighbors (Uruguay, Paraguay, Chile, Bolivia, Peru, etc.) is roughly the same as the proportional difference between the U.S. and Canada or Mexico. This Brazilian dominance is likely to translate into a clear leadership role for them, whatever economic arrangement they might choose to join, unless the United States and/or Canada are part of the same organization. Thus, Brazilian participation in a hemispheric free trade agreement would be, for them, a trade-off between the advantage of being tied to the world's largest economy versus the potential loss of control, influence, and prestige in being a distant second in the power hierarchy.

### Economic Progress by Latin American Nations

Finally, to understand the potential of Latin American nations to improve their economic condition and reduce the disparity between themselves and the U.S., it is important to identify whether developmental progress is being made in those countries. While the relative positions of the American nations have remained comparatively close over the 20 years of the study, the absolute leadership position of the U.S. has declined slightly over time. In population, GDP, exports, and the aggregate of all measures, the large Latin American countries have all made progress in relation to the U.S. The only areas where they have fallen further behind is military spending (which can be viewed as a neutral or even positive development from an economic perspective) and GDP per capita. This relative drop in "level of development" for all of the major Latin American nations is particularly troubling, because it indicates that, proportionally, the average citizen in Brazil, Mexico, Argentina, and Venezuela is getting further behind their U.S. and Canadian counterparts. It is also troubling that Brazil, the largest and most powerful nation in South America, was, in 1989, in the middle third of American nations in GDP per capita behind Venezuela, Argentina, and Mexico, as well as trailing smaller nations such as Trinidad and Tobago, Panama, and Uruguay. This growing disparity could potentially cause serious problems between Brazil and its Latin American trading partners and present an obstacle to treaty negotiation or ratification in the northern countries.

## Notes

[1]William J. Clinton, *A National Security Strategy of Engagement and Enlargement*, February 1995, pp. 2–3.

[2]Clinton, p. 4.

[3]Clinton, p. 4.

[4]Clinton, p. 19.

[5]Clinton, p. 20.

[6]Hans Binnendijk and Patrick Clawson, editors, *Strategic Assessment 1995: U. S. Security Challenges in Transition*, Washington: U. S. Government Printing Office, 1995, p. 91.

[7]Jeffrey Garten, "Clinton's Emerging Trade Policy," *Foreign Affairs*, Summer 1993, pp. 183–84.

[8]Paul Krugman, "The Uncomfortable Truth about NAFTA," *Foreign Affairs*, November/December 1993, p. 14.

[9]Krugman, p. 18.

[10]John Saxe–Fernandez, "After the Cold War: New Strategies in Latin American–United States Relations," *International Journal of Politics, Culture and Society*, Winter 1994, p. 238.

[11]See Gordon Mace, Louis Belanger, and Jean–Phillipe Therien, "Regionalism in the Americas and the Hierarchy of Power," *Journal of Interamerican Studies and World Affairs*, Summer 1993, pp. 115–57.

# Chapter 5

# Hemispheric Free Trade Issues and Analysis

The continued debate regarding NAFTA highlights many of the contentious issues associated with U.S. participation in hemispheric free trade agreements. This chapter will explore these issues, primarily focusing on the impact of each of them from a U.S. security perspective.

## The Real and Potential Economic Impact of Regional Free Trade

Perhaps the most hotly debated aspect of NAFTA was how much and in what ways the agreement would affect the United States. While the reasons behind U.S. support of NAFTA have already been discussed, several issues remain as to the potential negative impact the agreement would have on the U.S. economy. In a very real sense, these same arguments can be applied to the U.S. entering into a hemispheric trade pact. The anti-NAFTA argument is generally centered around (1) NAFTA would spur a massive relocation of American factory jobs to Mexico; (2) NAFTA is going to turn Mexico into one big “maquiladora” (a term used to describe a south-of-the-border manufacturing plant employing workers at sub-minimum wage, frequently disregarding basic working condition and environmental standards); (3) North American car production would shift to Mexico, which would make that country an Asian-style exporter, (4) Japan would soon build plants in Mexico, their new "duty-free" back door into the American market, (5) NAFTA costs too much ($40 billion is given as one figure) to implement at a time when we can't afford it.[1] After a careful look at these economic issues, considered arguments can be made against their logic.

**Relocation of American Factory Jobs**

This phenomenon is popularized by Ross Perot's "giant sucking sound" as U.S.-based plants go south to Mexico.[2] Gary Hufbauer and Jeffrey Schott argue that, while they estimate as many as 150,000 workers may be displaced (Paul Krugman quotes a high end figure of 500,000 from NAFTA's harshest critics[3]), this figure represents only 2 percent of the 9 million workers displaced in the United States between 1985-1990.[4] Most of those 9 million U.S. worker dislocations were caused by technological innovation, not trade dislocation. With U.S. tariff rates on Mexican imports already so low (four percent on manufactured items), the impact of dropping the tariff to zero is minimal. Regardless, Krugman argues, "the whole idea of counting jobs gained and lost through trade represents a misunderstanding of the way the U.S. economy works . . . other economic policies, especially monetary policy, will almost surely neutralize the negative impact of NAFTA on jobs."[5] He estimates that a change in the interest rates on the order of a fraction of one percent can easily offset any anticipated job losses.[6]

During NAFTA's first two years (1994 and 1995), the results have provided ammunition for both supporters and detractors of NAFTA. Because of the peso's collapse, 1994's 1.4 billion dollar U.S. trade surplus with Mexico has been replaced with 1995's 15 billion dollar trade deficit.[7] Additionally, Gary Hufbauer estimated in October 1995 that, largely due to the devalued peso and the surging trade deficit with Mexico, the

U.S. had lost 225,000 jobs.[8] While it is difficult to determine just how much of this was due to NAFTA, the U.S. Department of Labor estimated that 42,000 U.S. jobs had been lost because of the trade agreement as of September 1995.[9] Despite the job reductions, many U.S. business leaders and economists continue to assert that "short term" job counting is the wrong way to measure NAFTA effectiveness and potential. They argue that greater corporate efficiency, integrated marketing and production synergies, and the security of institutional guarantees against unexpected tariff increases are the truly significant, long-lasting economic impacts of NAFTA.[10]

**Mexico as One Big Maquiladora**

The transfer of American jobs to maquiladoras emanates from the fear that Mexican workers will be able to out-produce U.S. workers because of the difference in wages they demand ($1.95 an hour for the average Mexican worker compared to $15.60 an hour for the average U.S. worker in 1991, or roughly eight times as much). However, if value added per employee is compared ($72,740 in the U.S. versus $8,813 in Mexico, or a ratio of 8.2 to 1), the two workers produce almost exactly the same.[11] Given this comparison, an argument can be made that jobs, particularly high technology jobs with a greater value added per worker, are likelier to head north because of the more developed infrastructure there. Finally, the claim of mass job migrations overestimates the impact of labor costs and underestimates the costs of building new factories in foreign countries. Union-sponsored research indicates that, despite tremendous Mexican economic reforms, only 96,000 jobs have moved to Mexico over the past 15 years—less than the average monthly fluctuation in the size of the American work force.[12]

As mentioned in the previous section, the results of NAFTA's first two years (1994 and 1995) have been less than encouraging, with 42,000 NAFTA-related job losses as estimated by the U.S. Department of Labor. Many of these low-skill, low-pay jobs have migrated elsewhere, with Maquiladora employment rising by 20 percent (to 648,000) in the first two years of NAFTA implementation. At the same time, maquiladora labor costs (and employee purchasing power) have dropped dramatically from $2.54 per hour to $1.80 per hour due to peso devaluation.[13] The result is Mexican workers who have increased difficulty providing a decent standard of living for themselves and their families. Wayne A. Cornelius of the Center for U.S.-Mexican Studies asserts that, despite the increase in maquiladora employment, the overall number of Mexicans who have lost jobs due to NAFTA numbers in the hundreds of thousands, dwarfing the 42,000 Americans who have lost their jobs. Most of these jobs losses, he states, have come from the agricultural and industrial sectors, where small-time producers and inefficient manufacturers have shed workers to become more economically viable in the tariff-free environment.[14] Ironically, the downturn in Mexico has increased the number of migrant workers in the U.S., many of whom are not Spanish-speaking Mexicans, but, rather, Mexican Indians who speak various native dialects.[15] Yet, despite the serious short-term problems caused by peso devaluation, the situation in Mexico is beginning to show signs of promise. The Mexican stock market is at its highest since February 1994 and exports have risen to 30 percent of Mexico's gross domestic product. This high level of export income is expected to be "the winch that pulls the economy out of its hole."[16] NAFTA has been a significant part of Mexico's recovery and will provide the basis for increased long-term development on both sides of the border for years to come. Edward Leamers of Yale University summed it up by saying "If your time clock is year by year, then NAFTA was definitely oversold. If your clock runs a decade by decade, this is a more important event."[17]

### Car Production Shifting to Mexico

NAFTA removes Mexican import restrictions on U.S. and Canadian-made cars, allowing an increase of more than 400,000 vehicle exports from the U.S. and Canada annually. In 1993, Mexico was the fastest growing auto market in North America—this increase in import availability could spur U.S. and Canadian manufacturers to use their currently underutilized plant capacity. In the long run, this means job gains, not losses.[18] Despite short-term problems evident in NAFTA's first two years, a Chrysler vice-president stated "we firmly believe that there will be more total jobs and more jobs in the U.S." due to NAFTA.[19]

### Japanese Investment in Mexico

Despite strong incentives, Japanese investment in Mexico is relatively small, comprising less than five percent of Mexico's pre-NAFTA foreign investment. To guard against foreign investors using the agreement as a back door into the U.S., NAFTA "has increased the importance and complexity of the rules of origin to a much greater level than in any previous free trade area."[20] These restrictions are designed to lead outside investors to do just what the U.S. has encouraged them to do—invest their surplus dollars in a poor country which happens to be a loyal U.S. customer.[21] While foreign investment may increase in Mexico, the employment it creates, with the resultant income available to be spent on U.S. imports, is analogous to Honda or Toyota opening a plant in the United States.

**NAFTA Costs Too Much**

The $40 billion NAFTA price tag is largely generated from estimates of U.S. infrastructure improvements as a result of an increase in cross-border traffic. This type of cost is of direct benefit to citizens of the U.S. and much of it was sorely overdue to begin with. Another large cost is $10 billion in toxic waste and waterways cleanup, items that need to be addressed regardless of whether there is a NAFTA or not. Finally, $1.6 billion is estimated for worker retraining programs, much of which was previously generated from layoffs due to defense drawdown and other foreign competition—only a fraction of which can be attributed to NAFTA. Ultimately, only $600 million should be fairly ascribed to NAFTA, and most of that is from lost tariff revenues. Economically, the drop in tariffs should be overcome many times over by the increase in long term export revenue.[22]

**Summary of Economic Impact**

The long-term economic costs associated with NAFTA, both from the "pro" side (which acknowledges the significant short term unemployment and trade costs and freely admits that any short term economic advantages are relatively small compared to other factors), and the "con" side (which has a significant short term economic cost argument in light of 1994-5 data), are minor. Krugman summarizes this by saying "few studies indicate that NAFTA could add much more than 0.1 percent to U.S. real income,"[23] although Clinton Shiells, an economist at the International Monetary Fund, estimates GDP increase at 0.3 percent for the U.S. and 5 percent for Mexico.[24] As Mexico is by far the United States' largest trading partner in Latin America, the economic impact of trade agreements with other Latin American nations, for the short to medium term future, will be much less than that of the U.S. trade agreement with Mexico. Despite the arguably discouraging two-year returns on the trade agreement, the ultimate importance of NAFTA and hemispheric trade is the political and national security issues it entails.

## The Effect of Liberalizing Economies on Democratization

As stated previously, the third pillar of President Clinton's national security strategy of engagement and enlargement is "our promotion of democracy abroad." In Latin America, the turn toward democracy is considered highly vulnerable, where "effective democratic governance is unchallenged only in those very few countries—Chile, Costa Rica, Uruguay, and the Commonwealth Caribbean—where democratic traditions were already firmly implanted 35 years ago."[25] Indeed, Senator Ernest Hollings (D-South Carolina) raised his concern about NAFTA linking the U.S. with Mexico's "ruling oligarchy . . . (that) has systematically denied Mexican citizens free elections, free speech, basic civil liberties, and a genuinely free market."[26] Jorge Castaneda, a Professor of International Relations at the National Autonomous University of Mexico, maintains that, despite dramatic change over the past 50 years:

> Mexico's underlying problems persist. It remains largely a corrupt and unchallenged state that possesses only the merest trappings of the rule of law. The enduring obstacles to Mexico's modernization—its repeated failure to transfer power democratically or to remedy the ancestral injustice of its society—remain and will require Mexico to continue to change itself, with or without a trade accord.[27]

Furthermore, Castaneda asserts that ". . . (NAFTA) may exacerbate the country's already stark disparities and dislocation. Rather than speeding and facilitating Mexico's long-awaited and much-hoped-for democratic transition, the near term effect may be to slow the momentum for political reform."[28] To underscore just how dysfunctional Mexican "democracy" is, Alberto Aziz Nassif, a researcher at the Centro de Investigaciones y Estudios Superiores en Antropologia Social in Mexico City, repeats a new axiom of Mexican politics: "a change of president in Mexico is tantamount to political conflict and economic crisis."[29]

At the risk of making a gross generalization, it may be accurate to assert that the "new" Latin American democracies, most of whom had the same type of import-substitution economic policies before beginning the transition to market democracies, suffer from many of the same problems that Mexico does. How these countries may react politically to free trade agreements and the liberalizing of their economies is the critical question. It would be unwise, to say the least, for the U.S. to promote free market reforms and a hemispheric trading bloc if this works to undermine the stability of the very democracies we are trying to help. Guy Poitras and Raymond Robinson described the three most prominent views delineating the "ambiguous relationship between economic and political freedom:"

1. Economic freedom (open markets) and political freedom (democracy) must eventually coincide in Mexico because Mexico's government will gradually lose its ability to function effectively in a free market system based upon supply and demand;
2. Authoritarianism can help liberalization to advance by repressing popular resentment and preserving social order; and/or
3. There is no necessary connection between economic liberalization and democratization, nor is there a connection between economic liberalization and authoritari-

> anism. Though liberalization may require the aid of a strong authority at the outset, it may eventually also help to bring about its decline, if not demise.[30]

The debate as to how a NAFTA Mexico (and, by implication, other Latin American countries in a WHFTA) might develop in light of its need for political reform continues. Aziz Nassif felt that, in 1994, "economic reform has not led to democratic transition and economic integration into North America seems not to pass by way of internal democratization."[31] Arguably, the U.S. is actually impeding political liberalization in Mexico by supporting existing Mexican power elites, rather than allowing them to reach their own uncomfortable conclusions regarding the need for reform. Emilio Zebadua, of the Center for Historical Studies of the College of Mexico, summed up his perspective by saying that "even as the structural reforms of the economy are nearing the end, the political and social struggles are just beginning."[32]

## Who Gains? Wealth and Income Distribution Inequalities

Latin America, in general, and Mexico, in particular, have gross inequalities in the distribution of wealth among its people. The impact of Mexico's economic modernization has had a particularly pronounced effect on the income of its wealthiest citizens. In 1987, there was just one billionaire, now there are 24. The collective wealth of these 24 billionaires ($44.1 billion) exceeds the total income of the poorest 40 percent of Mexican households, representing approximately 33 million people.[33] The largest economy in Latin America, Brazil, has an equally disturbing maldistribution of wealth. The poorest 50 percent of Brazil's population have registered a constant decline in their share of the GDP since 1960, whereas the wealthiest 1 percent have seen a constant rise in their share and now represent greater wealth than the bottom half. This increasing polarization between the haves and the have nots is described as a society “em degenerescecia” (in degeneration) by Jose de Arimateia de Cruz, a Ph.D. Candidate at Miami University.[34] This pattern of income disparity is repeated throughout Latin America with Bolivia (72.0% of the population living in poverty), Peru (53.7%), Honduras (53.0%), Nicaragua (50.3%), Brazil (43.0%), and El Salvador (41.4%) having the highest poverty proportions of those countries measured.[35]

Income equity is critical to economic and political development. Shahid Javed Burki, the World Bank’s Vice President for Latin America and the Caribbean, and Sebastian Edwards, Chief Economist for Latin America and the Caribbean at the World Bank, assert that:

> Addressing the needs of the poorest citizens is a political as well as a social issue. Only to the extent that (the governments of Latin America and the Caribbean) succeed in reducing poverty and making income distribution more equal will countries be able to sustain recent structural reforms. Moreover, as a larger proportion of the population benefits from better education, nutrition, and health, growth will accelerate significantly.[36]

Recognizing the importance and interconnected synergism of economic, political, and social reform, Jorge Alcocer, Director of the Center of Studies for a National Project (in Mexico), goes even further when he insists that “the call for democracy must join a fundamental demand for social justice in today’s Mexico. We must create conditions for attaining a firm and stable redistribution of national income.”[37] This, he argues, should be done through creating stable and fairly paid jobs using “fiscal instruments and the instruments of a liberalized foreign trade.”

U.S. national security is directly related to the political, social, and economic stability of Latin America. One only need look at the United Nations peacekeeping effort in Haiti (led by the U.S.) to realize that this type of political, social, and economic chaos occurring on a grander scale, as would be the case in a "collapsed and destabilized" Mexico, would throw the U.S. into a security nightmare. The Zapatista revolt in Chiapas, described later in this chapter, is an example of the instability that can be caused by what is perceived as severe social injustice. While it appears that much of the recent economic gain realized by emerging democracies with free market economies is concentrated in the hands of an increasingly wealthier elite, it remains to be seen whether this will eventually translate into higher overall income for the citizens as a whole, including the poorest ones. It also is uncertain whether this growing income inequality will be exacerbated by a nation's inclusion into a free trade agreement, or whether joining an expanded NAFTA (if that is the selected model) actually helps alleviate social problems through "side agreements" on legal structures, the environment, labor issues, etc. Unfortunately, no firm conclusions can be accurately drawn at this time—it will take several years to determine the long-term effects NAFTA or MERCOSUR will have on this highly contentious issue.

## Societal Restructuring and Transition Costs

### Legal Institutions

One of the major U.S. concerns regarding NAFTA was the Mexican legal system. As described by Professor Castaneda, Mexico "remains largely a corrupt and unchallenged state that possesses only the merest trappings of the rule of law." Edgardo Buscaglia, Jr., a Professor of Law and Economics at Washington College, states specifically that "the introduction of legal institutions compatible with a market economy and improvements in the administration of justice ought to be considered as two of the most necessary complements to economic reform."[38] While "internal political and social forces pushed by NAFTA requirements" have forced Mexico to reconsider many of its legal institutions, Buscaglia asserts that "Mexico's laws respecting the activities of firms have not kept pace with the growing role of the private sector and the increasing role of foreign direct investment which is anticipated as a result of NAFTA."[39] In other words, the Mexican legal system is not adequate according to international standards, and still does not meet the needs of modern business. For the individual, Buscaglia contends, "the legal framework and the administration of justice must also provide the requisite much-needed access to the courts and make enforcement of property rights predictable."[40]

Legal reform is not only an issue with Mexico, it is also a problem with many Latin American societies who are emerging from decades of autocratic rule and are having difficulties transitioning to a market-oriented democratic society. The national security issues emerging from this are (1) is the U.S. binding itself to a nation (or nations) which is lacking in the basic legal guarantees for U.S. businesses and investment; and (2) in the interest of democracy and human rights, is it better to engage now (does it further institutional legal development towards those ends) or are we harming the very reforms we are trying to promote? Superimposed against U.S. interests is the willingness of each Latin American nation to change its legal structures based upon the insistence of the U.S. and its trading partners. While it may have been in Mexico's interest to approach the complicated issue of structural legal reform to make itself more attractive as a NAFTA partner, it is far from certain that other trading partners would be willing to do the same. While it appears NAFTA has prompted Mexico to begin legal reform, it is yet to be seen how far the reforms will go, whether they will be lasting reforms, and how they will they affect (positively or negatively) Mexican politics, society, structures, and stability.

**Environmental Concerns**

Regarded as a major victory for environmentalists inside and outside the U.S., "NAFTA is the first international trade agreement to have been negotiated under the close scrutiny of politically powerful environmental groups."[41] Derrick G. Wilkinson, a post-graduate student at the University of London, identified eight key environmental issues which are dealt with in NAFTA:

> The objective of sustainable development; the relationship between the trade agreement and international environmental agreements; the extraterritorial application of environmental policies; general exceptions for environmental policies; the establishment and enforcement of product standards; concerns regarding process and production methods (PPMs); the use of environmental tariffs and duties; and dispute settlement.[42]

Since the NAFTA signing, however, President Clinton's request for "fast-track" negotiating authority for future trade agreements has been denied by the U.S. Congress. This is significant in that it would have allowed the president to include strong environmental components directly into future trade agreements, rather than negotiating them on a case-by-case basis with individual countries, such as was done with Mexico in the NAFTA environmental side-agreement.[43]

Regardless of how difficult negotiations might be, the question remains as to whether or not environmental issues are a major concern in Latin American countries where there are more pressing issues, such as poverty and education. Robin L. Rosenberg, Deputy Director at the North-South Center at the University of Miami (FL), believes that "not all countries in the Western Hemisphere may be ready to adopt all the environmental standards of the NAFTA, and perhaps even fewer would be ready to sign off on a set of principles that commits them to (strong, environmentally sound) actions."[44] The environmental standards and policies in the NAFTA side-agreement are certainly a big step towards helping Mexico adopt the more stringent U.S. environment standards. It is also apparent that encouraging all nations of the world, including the U.S., to become more environmentally aware is in everyone's long-term security interests. The contentious issue here is national sovereignty. It is unquestionably important to encourage good environmental practices, yet, the U.S. (to include the powerful environmental lobby) should negotiate trade agreements with the realization that many Latin American nations are coping with grinding poverty and other powerful social issues that, by necessity, need to be effectively dealt with before long-term environmental progress can be made.

**Agriculture, Labor, and Migration**

In assessing the effects of NAFTA, one of the areas of most concern is the impact on agricultural workers on both sides of the border.[45] Linda Wilcox Young of Southern Oregon State College, quotes an estimate of 400,000 more people migrating from rural to urban areas over a 10-year period because of predicted falling agricultural wages due to NAFTA (this is in addition to the 1.1 million who would normally migrate).[46] This increased migration will undoubtedly strain an already overstressed urban infrastructure in Mexico. Wilcox Young estimates that real wages for U.S. agricultural workers will fall significantly because of displaced Mexican maize (corn) workers migrating to the U.S., thereby increasing the already oversupplied labor pool. Additionally, she cites American agricultural companies threatening to move to Mexico as a way to win even greater wage concessions from their employees.[47] The combination of a predicted increase in rural-urban migration in Mexico, Mexican agricultural migration to the U.S., and a decrease in wages for some of the lowest paid workers in the U.S. is a security issue for both countries.

Alan B. Simmons of York University identifies Mexican migration to the U.S. as primarily a function of employment opportunity and established social networks.[48] He also states that short-term downturns in the Mexican economy may have some impact, but even when they are dramatic, they are mostly "an acceleration of the growth in an already large flow."[49] In assessing the impact of NAFTA on Mexican migration, he identifies the removal of Mexican agricultural subsidies (particularly in corn), and the resultant drop in wages as perhaps spurring increased migration. Additionally, Simmons projects that, with potentially greater employment opportunities, Central Americans may migrate to Mexico in large numbers.[50] He also cites other historical large-scale migrations in Latin America, identifying the flow from Colombia to Venezuela, and the flow from Uruguay to Argentina and Brazil in the 1970s and 1980s as the two most significant examples. In both cases, economic crisis (low pay, unemployment, and inflation) was the driving force.[51] The historical experience suggests that free trade agreements will likely have a significant effect—with larger impact in specific sectors of the economy—on Latin American migration patterns. It might also have an important regional effect if there is a widespread impression in a "non-aligned" nation that opportunities are greater in an adjoining "free-trade" country. Ultimately, migration can be a major security issue for both the U.S. and Latin American nations. The NAFTA agreement itself has provisions for increased border enforcement and security. Additionally, significant anti-illegal immigration has been passed in U.S. border states, with Proposition 187 in California the most notable example. Increased border enforcement within the U.S., symbolized by presidential candidate Patrick Buchanan's proposed 2500-mile border fence, will likely create more political and economic pressures within Mexico and further contribute to increased strains between the two countries regarding this issue.[52]

## Chiapas, Political Instability, and the Peso Devaluation

After the signing of NAFTA in 1993, a series of events occurred in 1994 which undermined the great confidence foreign investors had in Mexico and Mexican economic reforms, culminating in the collapse of the peso in early 1995. Summarizing, Moises Naim, a senior associate at the Carnegie Endowment where he chairs Latin American programs, stated:

> The uprising in Chiapas, the assassinations of the PRI's presidential candidate, of a Roman Catholic cardinal, and of a leading PRI official, as well as a string of highly publicized kidnappings of Mexico's wealthiest businessmen, all greatly heightened anxiety.Suddenly the country faced both political uncertainty and economic fragility.[53]

Naim submits the peso devaluation was well overdue by the time of these crises, having been delayed by the NAFTA debate in 1993 and the Mexican presidential election in 1994. The end result was "within two weeks of the initial devaluation, the peso lost more than 30 percent of its value, and the Bolsa (Mexico's stock market) dropped almost 50 percent in dollar terms. By March (1995), a quarter of a million Mexicans had joined the ranks of the unemployed, and it is estimated that by the end of (1995), the unemployment rate will have quadrupled."[54]

## The Zapatista Revolt in Chiapas

On January 1st, 1994, the Zapatista National Liberation Army (EZLN) launched a completely unexpected assault and captured four cities in Mexico's southernmost state, Chiapas. The Zapatistas called for a nationwide movement for "jobs, land, housing, food, health, independence, freedom, democracy, justice and peace."[55] A mostly rural state, the people of Chiapas (chiapanecos) have a three times higher illiteracy rate than Mexicans as a whole and frequently lack the most basic necessities—electricity, drinking water, and drainage.[56] A combination of factors (rapid population growth, Guatemalan refugees fleeing political violence, increasing polarization of wealth, high unemployment, reduced real wages, and greatly reduced government spending in the name of economic reform) led to a situation ripe for alienation and political organization.[57] NAFTA itself was seen as a contributor to the revolution:

> While corn and beans continued to be subsidized, under NAFTA all tariffs and import quotas were gradually to be phased out. In combination with the ejido (state-owned farm) reform, these measures raised the prospect that landlessness and rural inequalities might soon grow much worse, as millions of campesinos, unable to compete with foreign imports, were forced off the land. The resulting insecurity and confusion fueled discontent throughout rural Mexico, providing the Zapatistas with a base of popular support on which to launch their rebellion.[58]

It is no coincidence, then, that the revolt took place on the day that NAFTA was approved. Part of the Zapatista demands include "an end to central government control over indigenous communities *and a renegotiation of NAFTA* (italics added)."[59] The implications of Chiapas are enormous, particularly if one ascribes to the same view as John Saxe-Fernandez, whereby "Chiapas is a symptom of a generalized condition that now affects the very fabric of Mexican society, because the main factors that led to the Zapatista rebellion are now present everywhere in the country."[60] While the roots of

Chiapas discontent are very deep and concern a wide range of issues, it is apparent that NAFTA exacerbated the situation and became a focal point for chiapanecos grievances. To the credit of the Salinas government, they sought a political close to the crisis and agreed to major changes in the Cabinet and the establishment of a Commission on Peace and Reconciliation.[61] A critical question for U.S. and Latin American decision-makers, however, is whether NAFTA, or any free trade agreement, will contribute to societal discontent and will it actually hurt the majority of poverty-stricken workers.

**Mexican Political Instability**

Immediately following the Chiapas revolt, a series of crises erupted which cast further doubt on Mexico's stability. Throughout 1994, more than 200 extortion-related kidnappings were reported, including those of two prominent Mexican businessmen: Alfredo Harp, Chairman of Banamex; and Angel Lozada, the son of the owner of the Gigante chain of department stores. During the midst of this, the PRI began to show disunity in its ranks, signs of "cracks that exist in the armor of the ruling party" which had governed Mexico for almost the entire twentieth century. Finally, the assassinations of two major political figures—Luis Donaldo Colosio, the PRI's original presidential candidate, and Jose Francisco Ruiz Massieu, slated to become the leader of the PRI in the Chamber of Deputies of the Mexican Congress under the new Zedillo government—"shocked the political system more than at any time in the past 60 years."[62] The Zapatista rebellion and the political turmoil clouded the atmosphere for Mexican society and the nation as a whole. When the devaluation took place at the end of 1994, Mexico was facing a crisis on three fronts: politically, economically, and in society.[63]

**Mexico's Economic Crisis and Its Aftereffects**

The sharp devaluation and loss of confidence by investors in Mexico's economic future has had dramatic effects on Latin America and its image, along with creating antagonisms between Mexico and some of its neighbors. Howard J. Wiarda, Professor of Political Science at the University of Massachusetts at Amherst, described the results of Mexico's crisis:

> punished by the 'sin' of geographic association, markets, banking systems, and investment in the rest of Latin America also began to suffer severe setbacks, even in such countries as Argentina and Brazil, which had not made the financial mistakes Mexico had. The bloom is clearly off the rose of viewing Latin America as in a new era and of the picture of happy, harmonious, US-Latin American relations that came out of the Miami Summit. Excessive pessimism has replaced the earlier excessive optimism. The earlier notions of Latin America as a natural trading partner or an 'opportunity area' for the United States are fading; 'transparency' is gone. Investment to the area has slowed and almost stopped in some cases; the Mexico case is being used by revived statist elements throughout the area to argue that the free market approach is incorrect or must be drastically slowed. The faith in relatively easy and peaceful transitions to democracy is being severely strained, particularly because of Mexico's difficulties, and Latin America is again, after all the hopes of recent years, being seen as backward, corrupt, inefficient, unstable, and ungovernable—all the banana republic traits that the area and its supporters in the United States have struggled so hard for so long to overcome.[64]

To stabilize Mexico and prevent its possible collapse, the U.S. came to Mexico's rescue with a $20 billion bailout, with an additional $30 billion coming from the World Bank, the International Monetary fund, other Western Allies, Japan, and several Latin American countries.[65] Analyzing the situation, Wiarda believes "the markets overreacted to the Mexican situation and punished it, and other countries, inordinately and beyond what they deserved."[66] Wiarda comes to five broad conclusions regarding the Mexican crisis and its aftermath:

1. The economic modernization of Latin America is still very fragile, partial, and incomplete;
2. The market has also shown us that those countries may be less stable politically than the hopefulness of the Miami Summit seemed to imply;
3. The market has similarly told us that the transition to democracy, in Mexico and elsewhere, is far more uncertain and precarious than these antiseptic phrases and sanitized policy pronouncements would suggest;
4. A fourth casualty of the Mexican peso crisis has been transparency; and
5. Finally, the market correction in Mexico has revealed that the United States and Latin America are not, contrary to the Miami "Declaration of Principles," on exactly the same wavelength.[67]

The peso crisis has affected the prospects for a WHFTA, in the near term, dramatically. The lack of support among U.S. policy makers indicates that any expansion of NAFTA will have to wait for the memories of Chiapas, political turmoil in Mexico, and the peso devaluation to fade away. Yet, a hemispheric free trade agreement is still a part of U.S. and Latin American long-term security policy. It is up to leaders in both the U.S. and Latin America to determine how best to accomplish this goal, while dealing with the myriad of trade-related issues in all Western Hemisphere countries.

## Notes

[1]Orme, pp. 4–10.
[2]as quoted in Hufbauer and Schott, "Prescription for Growth," p. 106.
[3]Krugman, p. 15.
[4]Hufbauer and Schott, "Prescription for Growth," pp. 105–06.
[5]Krugman, p. 14.
[6]Krugman, p. 16.
[7]Allen R. Myerson, "Out of a Crisis, an Opportunity," *The New York Times*, September 26, 1995, p. C1.
[8]As quoted in Bob Davis, "Two Years Later, the Promises Used to Sell Nafta Haven't Come True, but Its Foes Were Wrong, Too," *The Wall Street Journal*, October 26, 1995, p. A24.
[9]James Sterngold, "Nafta Trade–Off: Some Jobs Lost, Others Gained," *The Wall Street Journal*, October 9, 1995, p. A1.
[10]Sterngold, pp. A1 and A13.
[11]Hufbauer and Schott, "Prescription for Growth," pp. 106–07.
[12]Orme, p. 5.

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[13]Davis, p. A24.

[14]Wayne A. Cornelius, "Nafta Costs Mexico More Job Losses Than U.S.," *The New York Times*, October 17, 1995, Editorials/Letters section.

[15]Seth Mydans, "A New Wave of Immigrants On Lowest Rung in Farming," *The New York Times*, August 24, 1995, p. A1.

[16]Julia Preston, "Mexico Stocks Leap 5.4%, Injecting Optimism," *The New York Times*, January 3, 1996, p. C1.

[17]As quoted in Sterngold, p. A13.

[18]Orme, p. 6.

[19]James D. Conlon, as quoted in Sterngold, p. A13.

[20]P. J. Lloyd, "A Tariff Substitute for Rules of Origin in Free Trade Areas," *The World Economy*, November 1993, p. 703.

[21]Orme, p. 8.

[22]Orme, p. 10.

[23]Krugman, p. 17.

[24]Clinton Shiells, "Regional Trade Blocs: Trade Creating or Diverting?" *Finance & Development*, March 1995, p. 32.

[25]Abraham F. Lowenthal, "Latin America: Ready for Partnership?" *Foreign Affairs*, 1993, p. 82.

[26]Ernest F. Hollings, "Reform Mexico First," *Foreign Policy*, Winter 1993–94, p. 91.

[27]Jorge G. Castaneda, "Can NAFTA Change Mexico?" *Foreign Affairs*, September/October 1993, p. 68.

[28]Castaneda, p. 68.

[29]Alberto Aziz Nassif, "Mexico, 1994," *International Journal of Political Economy*, Fall 1994, p. 98.

[30]Poitras and Robinson, p. 2.

[31]Aziz Nassif, p. 94.

[32]Emilio Zebadua, "The Heralded Revolution," *International Journal of Political Economy*, Fall 1994, p. 85.

[33]Robin Broad and John Cavanaugh, "Don't Neglect the Impoverished South," *Foreign Policy*, Winter 1995–96, p. 27.

[34]Jose de Arimateia da Cruz, "Book Review: Democratic Consolidation and the Socio–Economic Crisis of Latin America," *Journal of Interamerican Studies and World Affairs*, 1993, p. 148.

[35]Shahid Javed Burki and Sebastian Edwards, "Consolidating Economic Reforms in Latin America and the Caribbean," *Finance & Development*, March 1995, p. 8.

[36]Javed Burki and Edwards, p. 8.

[37]Jorge Alcocer, "Mexico: Modernity without Equality," *International Journal of Political Economy*, Fall 1994, p. 66.

[38]Edgardo Buscaglia, Jr., "Review Essays: Legal and Economic Development in Mexico: The Steps Ahead," *Journal of Interamerican Studies and World Affairs*, Summer 1994, p. 199.

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[39]Buscaglia, Jr., p. 201.

[4040]Buscaglia, Jr., p. 203.

[41]Derrick G. Wilkinson, "NAFTA and the Environment: Some Lessons for the Next Round of GATT Negotiations," *The World Economy*, May 1994, p. 395.

[42]Wilkinson, pp. 395–96.

[43]Robin L. Rosenberg, "Trade and the Environment: Economic Development versus Sustainable Development," *Journal of Interamerican Studies and World Affairs*, Fall 1994, p. 140.

[44]Rosenberg, pp. 151–52.

[45]Linda Wilcox Young, "Free Trade or Fair Trade? NAFTA and Agricultural Labor," *Latin American Perspectives*, Winter 1995, p. 50.

[46]Wilcox Young, p. 50.

[47]Wilcox Young, p. 55.

[48]Alan B. Simmons, "Latin American Migration to Canada: New Linkages in the Hemispheric Migration and Refugee Flow System," *International Journal*, Spring 1993, p. 291.

[49]Simmons, pp. 291–92.

[50]Simmons, pp. 305–06.

[51]Simmons, pp. 292–93.

[52]Patrick J. Buchanan, "Mexico: Who Was Right?" *The New York Times*, August 25, 1996, Editorials/Letters section.

[53]Moises Naim, "Mexico's Larger Story," *Foreign Policy*, Summer 1995, p. 118.

[54]Naim, "Mexico's Larger Story," p. 119.

[55]Josefina Morales, "Two Reviews: NAFTA and the Zapatistas," *International Journal of Politics, Culture and Society*, Winter 1994, p. 349.

[56]Stephen J. Wager and Donald E. Schulz, *The Awakening: The Zapatista Revolt and Its Implication for Civil–Military Relations and the Future of Mexico*, Carlisle Barracks, PA: Strategic Studies Institute, 1994, p. 2.

[57]Wager and Schulz, pp. 3–5.

[58]Wager and Schulz, p. 6.

[59]Wager and Schulz, p. 23.

[60]John Saxe–Fernandez, "The Chiapas Insurrection: Consequences for Mexico and the United States," *International Journal of Politics, Culture and Society*, Winter 1994, p. 332.

[61]Raul Benitez Manaut, "Afta NAFTA," *Hemisphere*, Summer 1994, p. 25.

[62]Gary L. Springer and Jorge L. Molina, "The Mexican Financial Crisis: Genesis, Impact, and Implications," *Journal of Interamerican Studies and World Affairs*, Summer 1995, pp. 60–62.

[63]Springer and Molina, p. 63.

[64]Howard J. Wiarda, "After Miami: The Summit, the Peso Crisis, and the Future of US–Latin–American Relations," *Journal of Interamerican Studies and World Affairs*, Spring 1995, pp. 44–45.

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[65]Wiarda, p. 60.
[66]Wiarda, p. 62.
[67]Wiarda, pp. 62–64.

# Chapter 6

# Conclusion

Latin America is emerging from a long history of trade protectionism and authoritarian governments into an era of market-oriented economies and emerging democratic institutions. Within the past five years, two major free trade areas, NAFTA and MERCOSUR, have emerged in North and South America and hold the promise of expanding trade between all involved parties. Yet, despite the economic basis of both agreements, the overriding importance of NAFTA and MERCOSUR is as instruments of foreign policy, binding the signatories into a "national security" pact. NAFTA, specifically, is identified as critical U.S. support for Mexico's stability and institutional reform. Considered vital to U.S. security, the proposed WHFTA from the Miami Summit is intended to create greater cooperation between the U.S. and its Latin American neighbors. Ultimately, NAFTA and WHFTA are seen as key ingredients for our national security strategy of "engagement and enlargement," directly supporting the U.S. objectives of opening foreign markets, spurring global economic growth, and promoting democracy abroad. It is clear that WHFTA, as embodied by the spirit and declarations of the Summit of the Americas, is designed to capitalize on the increased feeling of good will and cooperation among almost all nations of the Western Hemisphere.

Yet, problems remain. Mexico and its economic and political development is seen as a bellwether for Latin America. Led by an allegedly corrupt and oligarchic democracy, Mexico's problems are many: severe income inequity, questionable legal institutions, undeveloped environmental standards, high unemployment, rural-urban and U.S. migration, the revolution in Chiapas, political instability, and the collapse of the peso. Indeed, NAFTA may actually increase prospects for short-term destabilization by limiting Mexican government options. The cumulative effect of Mexico's problems has been dramatic. This country that was recently the focus of tremendous international investment is now seen as politically unstable and financially unreliable. Much to the misfortune of other Latin American countries, they have also been judged in this same manner by foreign investors, rightly or wrongly. The enthusiasm for a WHFTA has waned tremendously and talks on the expansion of NAFTA to South America (Chile) are "on hold."

Despite these problems and the myriad of negotiation and implementation obstacles to overcome, WHFTA remains a highly worthwhile long-term objective for the United States. The economic costs are relatively small (in spite of Mexico's $50 billion "bailout") and the potential long-term gains could be quite large, especially if Latin America develops along the lines of the "Asian Tigers" (Singapore, Hong Kong, Taiwan, and South Korea). More importantly, seizing this window of opportunity and creating closer ties with Latin America could provide critical economic and political assistance to fledgling democracies, helping to increase their chances for institutional reform and eventual survival. Whether this "alliance" takes the form of an expanded NAFTA (with new members in an "associate" or "full-fledged member" status), a merging of NAFTA and MERCOSUR, or a series of bilateral agreements between the U.S. and other nations is relatively unimportant for the immediate future.  The truly critical issue is that the U.S. needs to take a long-term perspective on the national security interests these free trade agreements represent, and remain engaged in the process of expanding our ties to Latin America.  To succumb to the politics of fear and allow the EC or APEC to gain the economic initiative in South America or, worst of all, to abandon NAFTA in light of Mexico's crisis would be very damaging to U.S.-Latin American relationships and shortsighted in the extreme.

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